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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 14

RIN 3038-AE21

Proceedings before the Commodity Futures Trading Commission; Rules Relating to Suspension or Disbarment from Appearance and Practice

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission (“Commission” or “CFTC”) amends its regulations to clarify the standard used for determining when an accountant has engaged in “unethical or improper professional conduct”—grounds for a temporary or permanent denial of the privilege to practice before the Commission. The amendment enhances transparency by codifying the standard used in Commission adjudications of accountant conduct under the Commission’s regulations.

DATES: This rule is effective [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

I. Background

Part 14 of the Commission's regulations addresses the circumstances under which the Commission may deny attorneys and accountants, temporarily or permanently, the privilege of practicing their respective professions before it. Rule 14.8 specifically provides that the Commission, after notice and opportunity for a hearing and an adverse finding by a preponderance of the evidence, may bar an attorney or accountant found: (a) not to possess the requisite qualifications to represent others; or (b) to be lacking in character or integrity; or (c) to have engaged in unethical or improper professional conduct either in the course of an adjudicatory, investigative, rulemaking, or other proceeding before the Commission or otherwise.¹

Prior to this amendment, rule 14.8 did not further articulate what constitutes "unethical or improper professional conduct" by an accountant under paragraph (c). However, since 1996, the Commission has filed six administrative actions alleging violations of rule 14.8 against accountants appearing and practicing before it.² In each case, the Commission accepted a settlement banning the defendants from practicing before it for a specified time period.

¹ 17 CFR 14.8.

² In re Deloitte & Touche and Thomas Lux, CFTC Docket No. 96-10, 1996 WL 547883 (CFTC September 25, 1996); In re Sherald Griffin, CPA & Donna Laubscher, CPA, CFTC Docket No. 98-12, 1998 WL 161709 (CFTC April 8, 1998); In re Anatoly Osadchy, CPA, CFTC Docket No. 99-2, 1998 WL 754637 (CFTC October 29, 1998); In re G. Victor Johnson and Altschuler, Melvoin & Glasser, LLP, CFTC Docket No. 04-29, 2005 WL 1398672 (CFTC June 13, 2005); In re G. Victor Johnson II, McGladrey & Pullen, LLP and Altschuler, Melvoin & Glasser, LLP, CFTC Docket No. 11-01, 2010 WL 3903905 (CFTC October 4 2010); In re Jeannie Veraja-Snelling, CFTC Docket No. 13-29, 2013 WL 4647784 (CFTC filed Aug. 26, 2013).

Section 201.102(e) of the Securities and Exchange Commission’s (“SEC’s”) regulations (“SEC rule of practice 102(e)”) ³ addresses the standard of conduct for accountants practicing before that commission. Parallel to Commission rule 14.8, SEC rule of practice 102(e)(1)(ii) sets out “unethical or improper professional conduct” as grounds for accountant suspension and disbarment from practice before the SEC. As amended in 1998, ⁴ the SEC regulation further provides that with respect to persons licensed to practice as accountants, “improper professional conduct” under SEC rule of practice 102(e)(1)(ii) means intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or either of the following two types of negligent conduct: A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted; or repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission. ⁵

The standard for accountant “improper professional conduct” expressed in SEC rule of practice 102(e)(1) is consistent with that applied by the Commission in its earlier-referenced adjudications of accountant conduct under rule 14.8.

II. The Proposed Amendment to Rule 14.8; Consideration of Comments

On October 23, 2014, the Commission published a proposed amendment to rule 14.8 (“the Proposal”) for public comment. ⁶ As proposed, the amendment sought to add

³ 17 CFR 201.102(e).

⁴ See Amendment to Rule 102(e) of the Commission’s Rule of Practice, 63 FR 57164 (Oct. 26, 1998).

⁵ 17 CFR 201.102(e)(1)(iv).

⁶ Proceedings before the Commodity Futures Trading Commission; Rules Relating to Suspension or Disbarment from Appearance and Practice, 79 FR 63343 (Oct. 23, 2014).

language to rule 14.8(c) to clarify the meaning of accountant “improper professional conduct.” As explained in the Proposal, the proposed amendment mirrors in substance the standard prescribed in SEC rule of practice 102(e)(1)(iv), and comports with the standard historically applied by the Commission in adjudications of accountant conduct.

The Commission received three comments on the Proposal.⁷ Each commenter supported the amended rule as proposed without raising substantive issues. For example Deloitte LLP stated that it “support[s] the CFTC’s decision to seek regulatory consistency by adopting a definition that is identical to the definition provided under Rule 102(e) of the Rules of Practice of the U.S. Securities and Exchange Commission.”⁸ Ernst & Young LLP wrote that “[a]dopting a rule that is modeled after SEC Rule 102(e), which would be the case with respect to the proposed amendment, strikes us as a reasonable approach given the lengthy history and background of the SEC’s rule.”⁹ A third commenter wrote that the proposed rule “requires the accountant to act with integrity and perform its duties with competence and care and will promote market integrity, ensure regulators consistency (with the SEC), enhance customer protection and improve risk management.”¹⁰ Accordingly, the Commission is adopting the amendment to rule 14.8, as proposed.

III. Role of and Standards Applied to Accountants

Accountants auditing Commission registrants perform a critical gatekeeper role in protecting the financial integrity of the derivatives markets and the investing public.

⁷ The three commenters on the proposed rule amendment were Ernst & Young LLP, Deloitte LLP and Chris Barnard.

⁸ Deloitte LLP Comment Letter at 1 (November 24, 2014).

⁹ Ernst & Young LLP Comment Letter at 1 (November 24, 2014).

¹⁰ Chris Barnard Comment Letter at 2 (November 4, 2014).

Accountants appearing before the Commission in this capacity must understand the business operations of their clients and conduct financial audits both in accordance with applicable professional principles and standards and in satisfaction of all the requirements of the Commission's regulations.¹¹

Rule 14.8 can be an effective remedial tool to ensure that the accountants appearing before the Commission are competent to do so and do not pose a threat to the Commission's registration and examination functions. Accountants who engage in intentional or knowing misconduct, which includes reckless conduct, clearly pose such a threat, as do accountants who engage in certain specified types of negligent conduct.

The Commission believes that a single, highly unreasonable error in judgment or other act made in circumstances warranting heightened scrutiny conclusively demonstrates a lack of competence to practice before the Commission. Repeated unreasonable conduct may also indicate a lack of competence. Therefore, if the Commission finds that an accountant acted egregiously in a single instance or unreasonably in more than one instance and that this conduct indicates a lack of competence, then that accountant engaged in improper professional conduct under rule 14.8's standard.

The amendment to rule 14.8 is not meant, however, to encompass every professional misstep. A single judgment error, for example, even if unreasonable when made, may not indicate a lack of competence to practice before the Commission sufficient to require Commission action. The amendment seeks to provide greater clarity

¹¹ The current professional principles and standards applicable to accountants appearing before the Commission include Generally Accepted Accounting Principles, Generally Accepted Auditing Standards, International Accounting Standards, the Code of Conduct of the American Institute of Certified Public Accountants, and the rules and standards of the Public Company Accounting Oversight Board.

with respect to the Commission's standard for assessing accountant conduct, as developed to-date through administrative adjudications. At the same time, however, like the SEC regulation after which the amendment is modeled, the amendment elaborates standards that are to be applied in adjudications on a case-by-case basis, a method that promotes equitable application of the standards as warranted upon full consideration of the facts of each case.

Similarly, as the SEC noted when it amended its rule of practice in 1998,¹² the Commission does not seek to use rule 14.8 to establish new standards for the accounting profession. The rule itself imposes no new professional standards on accountants. Accountants who appear or practice before the Commission are already subject to professional standards, and rule 14.8(c) is intended to apply in a manner consistent with those existing standards.

IV. Related Matters

A. Regulatory Flexibility Act

The Regulatory Flexibility Act requires agencies to consider whether the rules they may adopt will have a significant economic effect on a substantial number of small entities.¹³ This amendment simply clarifies the standard by which the Commission determines whether accountants have engaged in "improper professional conduct" and does not impose any additional burdens on small businesses. Accordingly, the Chairman, on behalf of the Commission, hereby certifies, pursuant to 5 U.S.C. 605(b), that the amendment will not have a significant economic impact on a substantial number of small businesses.

¹² See 63 FR 33305 (June 18, 1998); 63 FR 57164 (Oct. 26, 1998).

¹³ 5 U.S.C. 601 et seq.

B. Paperwork Reduction Act

The amendment to Rule 14.8 does not establish a collection of information for which the Commission would be obligated to comply with the Paperwork Reduction Act.¹⁴

C. Consideration of Costs and Benefits

Section 15(a) of the Commodity Exchange Act (“CEA”) requires the Commission to “consider the costs and benefits” of its actions before promulgating a regulation under the CEA or issuing certain orders.¹⁵ Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

Reckless accounting practices threaten serious harm to market participants and, potentially, to the financial system as a whole.¹⁶ Rule 14.8, which encompasses “improper professional conduct” of accountants that practice before the Commission, is one of the Commission’s tools to guard against such harm. The amendment does not substantively change the standard that the Commission has employed to date under rule

¹⁴ 44 U.S.C. 3501 et seq.

¹⁵ 7 U.S.C. 19(a).

¹⁶ For example, accounting professionals who prepare or assist in the preparation of misleading auditing reports or financial statements—either deliberately or due to their incompetence—may help cover up fraudulent practices that result in loss of customer funds. In addition, misleading auditing reports or financial statements may result in excessive risks being undertaken, because certain risk measures or decisions regarding risk management are based on accounting data.

14.8(c) in assessing accountant conduct. Rather, as discussed above, the amendment—which closely tracks language in the SEC’s analogous rule¹⁷—simply expands upon the pre-existing language of rule 14.8(c) to articulate the standard more specifically and in a manner consistent with the standard the Commission has applied in past administrative adjudications considering accountant behavior.¹⁸

Accordingly, the amendment’s chief benefit derives from clarifying the specific contours of the Commission’s existing rule 14.8(c) standard as applied to accountant behavior and by codifying this refined approach in the Commission’s regulations. Through this codification, the standard will be more transparent and accessible to professional practitioners, market participants, and the public generally. As a result, accountants appearing before the Commission will have the benefit of prominent notice of the specific standards of conduct to which they are held, and the consequences of failing to meet them. To the extent an accountant inclined to test the bounds of professional conduct may have previously perceived loopholes or ambiguity for exploitation under the generally-stated standard of rule 14.8(c), the clarifying amendment provides a deterrent against such potentially damaging conduct—a benefit for market participants and the public. Further, such clear, specific notice forecloses to a great degree potential for an offending accounting practitioner, in defense of improper conduct, to argue confusion or uncertainty about what specifically the Commission’s standard requires, thus supporting Commission enforcement efficiency.

The Commission anticipates no material cost burden attributable to the amendment for market participants or accounting professionals to whom the amendment

¹⁷ 17 CFR 201.102(e)(1)(iv).

¹⁸ See note 2, supra.

is addressed. Again, this amendment merely articulates with more precision the contours of the more generally-stated standard of rule 14.8(c) as it has existed prior to this amendment; further, this pre-existing standard has encompassed standards governing the accounting profession generally and with which accounting professionals have needed to comply. Since the clarifying amendment effects no substantive change to the rule 14.8 standard, accountants practicing before the Commission should already be in compliance. Consequently, they should experience no cost to change their behavior to comply with the rule as amended.

In the following, the Commission considers the amendment relative to the CEA section 15(a) factors.

(1) Protection of Market Participants and the Public

As noted, improper accounting practices may help to cover up financial frauds or foster improper managerial decisions and may pose a threat to the safety of customer funds. By articulating the Commission's standards in more specific, codified, and readily accessible form, the amendment safeguards against accountants professing lack of knowledge of the applicable standards—or exploiting perceived ambiguities in them—to the detriment of market participants and the public.

(2) Efficiency, Competitiveness, and Financial Integrity of Futures Markets

Threats to the safety of customer funds generate public distrust in financial market integrity. To the extent this rule amendment better informs accountants and fosters their understanding of the Commission's standards and the consequences of improper actions—actions that potentially could threaten the safety of customer funds—the amendment promotes the integrity of financial markets.

(3) Price Discovery

The Commission does not foresee that the amendment will directly impact price discovery.

(4) Sound Risk Management Practices

As noted, improper accounting practices may lead to unnecessary risks being undertaken, as certain risk measures or managerial decisions are based on accounting data. To the extent the amendment improves accountants' understanding of the Commission's standards, thereby deterring improper conduct that potentially could result in unnecessary risks being undertaken, the amendment promotes sound risk management practices.

(5) Other Public Interest Considerations

By harmonizing the rule 14.8(c) standard for accountants with that of SEC rule of practice 102(e), the amendment helps to ensure consistency and reduces potential for confusion.

List of Subjects in 17 CFR Part 14

Administrative practice and procedure, Professional conduct and competency standards, Ethical conduct, Penalties.

For the reasons discussed in the preamble, the Commodity Futures Trading Commission amends 17 CFR part 14 as set forth below:

PART 14--RULES RELATING TO SUSPENSION OR DISBARMENT FROM APPEARANCE AND PRACTICE

1. The authority citation for part 14 is revised to read as follows:

Authority: Pub. L. 93-463, sec. 101(a)(11), 88 Stat. 1391, 7 U.S.C. 4a(j).

2. Amend §14.8 by revising paragraph (c) to read as follows:

§ 14.8 Lack of requisite qualifications, character and integrity.

* * * * *

(c) To have engaged in unethical or improper professional conduct either in the course of any adjudicatory, investigative or rulemaking or other proceeding before the Commission or otherwise. With respect to the professional conduct of persons licensed to practice as accountants, “unethical or improper professional conduct” means:

(1) Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional principles or standards; or

(2) Either of the following two types of negligent conduct:

(i) A single instance of highly unreasonable conduct that results in a violation of applicable professional principles or standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.

(ii) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional principles or standards, which indicate a lack of competence to practice before the Commission.

Issued in Washington, DC on June 5, 2015, by the Commission.

Christopher J. Kirkpatrick,

Secretary of the Commission.

Note: The following appendix will not appear in the Code of Federal Regulations.

**Appendix to Proceedings before the Commodity Futures Trading Commission;
Rules Relating to Suspension or Disbarment from Appearance and Practice –
Commission Voting Summary**

On this matter, Chairman Massad and Commissioners Wetjen, Bowen, and Giancarlo voted in the affirmative. No Commissioner voted in the negative.

[FR Doc. 2015-14159 Filed: 6/9/2015 08:45 am; Publication Date: 6/10/2015]